**SARS and the taxation of trusts – they talk softly but carry a big gun**

*By Franscois van Gijsen, CFP®, FPSA®, MTP(SA)™, a member of FISA and Director: Legal Services at Finlac Risk and Legal Management.*

It has been two years now since Finance Minister at the time, Pravin Gordhan, set the cat amongst the pigeons in his 2013 budget speech and declared that: *"Discretionary trusts should no longer act as flow-through vehicles. Taxable income and loss (including capital gains and losses) should be fully calculated at trust level with distributions acting as deductible payments to the extent of current taxable income."* With the conduit principle as entrenched as it is in our tax law, it is no surprise that these proposed changes caused a lot of concern among practitioners. Subsequent to this announcement a number of meetings were held between treasury and role-players in the industry and, as no changes have since been made to the Income Tax Act regarding the taxation of trusts as it pertains to the conduit principle, one could perhaps be forgiven for thinking that treasury has given up on trying to reduce the erosion of the tax base through the use of discretionary trusts. If this is what anybody thinks, I believe they are sorely mistaken.

What has in fact happened is that SARS introduced its new "Modernised Income Tax return for trusts" the ITR12T, from 6 October 2014. This form provides for much fuller reporting on the part of the trust than was previously the case and it is in these new reporting requirements that I perceive first rumblings of war. A letter introducing the new form summarises the transactional details in regard to the year of assessment that now have to be provided as follows:

- Capital or revenue distributed or vested in beneficiaries
- Distributions or vesting of non-taxable income
- Distribution or vesting of capital or assets
- Loan(s) granted and received
- Donation(s) or contribution(s) made or received
- Distributions received from other trusts or foundations
- Refund(s) received on contribution(s) made to this trust
- The right of use of asset(s) granted.

Trusts with 50 or fewer distinct persons to whom the above mentioned transactions applied during the year of assessment have to provide the details of each transaction for every person, while trusts with more than 50 distinct persons to whom such transactions applied during the year of assessment have to provide details of such transactions at a consolidated level and the details of each transaction for every person (limited to 50) with the highest transactions in excess of R500 000. Furthermore, this information, while not required for the completion of returns for the 2014 tax year, is mandatory from the 2015 tax year.

I'll try to illustrate the import of this new information in the hands of SARS, by means of two examples:

a) By placing assets in trust, taxpayers reduce the size of their estates and reduce their estate duty liability. However, the loss to the *fiscus* is essentially made good by the fact that trusts are taxed at a higher rate than other persons. Persons availing themselves of a trust are then on an annual basis confronted with the choice of, either paying the higher rate of income tax in the trust and excluding the assets from their estates for estate duty purposes, or vesting the income or capital in the beneficiaries. This vesting allows them to reduce the tax payable now, but places the asset in the estate of the beneficiary and subject to estate duty upon their death. By requiring details of distributions and decisions to vest, SARS has now created a paper trail which allows them to ensure that the recipient of the benefit is taxed in the present tax year and that the benefit is later declared in their estate duty declarations upon death. In the past it happened that executors, who may not necessarily be professional fiduciary practitioners, would fail to declare the vested interests in trusts when administering an estate – not so much from a lack of honesty, but more likely, from a lack of knowledge.

b) By keeping track of loans and requiring a declaration of the rates of interest payable on such loans, SARS has effectively opened up the possibility to start levying tax on "deemed interest" should the creditor fail to charge interest on the loan. This could, potentially, be done by levying donations tax on the "donation" of the deemed interest; or where there is a *quid pro quo* for the loan being interest free, by levying income tax on the loan. This last scenario happened in the case of Commissioner for SARS v Brummeria Renaissance (Pty) Ltd [2007] 4 All SA 1338 (SCA) where it was held that the value of a legally

enforceable right to the interest-free use of loan capital had to be included in the companies' gross income for the years in which such rights accrued to the companies.

SARS, in Interpretation note 58 (October 2012), correctly points out that the value of a receipt or accrual in a form other than money would ordinarily not have to be included in gross income, if such was not received or accrued in exchange for goods supplied or services rendered, as such receipts or accruals would likely be of a capital nature. However, while it may not at present be SARS' practice to attempt to levy CGT on such interest free loans, having this information handed to them annually will certainly make it easier to start doing so should they, in their search for larger inflows, decide to do so. And, based on their requiring information on the use of properties, I would argue that they will in the foreseeable future look at collecting CGT on these, non-cash capital receipts.

Trustees should think long and hard about their decisions to distribute or vest income or capital in beneficiaries. It makes little sense, where a trust has been chosen as a vehicle to assist in an estate planning exercise, to go to the trouble and expense of placing assets in trust only to erode the expected benefits, both in regard to estate duty savings and protection of assets, by transferring the interest in generated asset growth back into the hands of beneficiaries in order to obtain an immediate tax benefit. The assets could then just as easily have remained in the hands of the original owner. The thing about tax planning, I have long said, is that it is relatively easy to obtain some small reduction of tax liability in any specific year. The challenge is to correctly value the impact that today's decision will have in later tax years. This seems to be the case now more than ever. SARS, with the new reporting requirements in regard to trusts, seems set to remove all of the perceived tax benefits to using a trust, and those persons who continue administering trusts and making tax decisions without taking this into consideration are likely to soon find the Receiver at their door, talking softly but carrying a big gun.